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SUBJECT: CLIMATE CHANGE: EMISSION TRADING PAPER REACTIONS

REF: A. CANBERRA 719
¶B. CANBERRA 686

¶1. (SBU) Summary: The July 16 release of the Rudd government's Green Paper setting up the Carbon Pollution Reduction Scheme (CPRS) emissions trading system has laid out the banquet for an escalating round of maneuvering by industry, government and the Opposition. The details provided in the 532-page tome (ref A), although leaving key questions unanswered, have given all sides enough ammunition to begin to take their cases public. While everyone has room to find fault with the plan, the general outlines set by the government have left little ground for outright opposition, and only the far right-wing of the opposition is suggesting that it might not be a good idea to implement emissions trading at all. Public polling indicates strong support for, but little understanding of, the planned scheme. NGOs are withholding complete endorsement and waiting to see how the government moves ahead. End Summary.

A Resounding Thud

¶2. (SBU) Those expecting either a vague, noncommittal document or one that maps out clearly the trajectory for jumping into emissions trading were disappointed. While many agree that the document was more detailed that expected, it leaves open many key issues, including when exactly it will go into affect. Sources tell us that the government originally had drafted an even more comprehensive plan, which was rejected by Cabinet because it did not match with promises being made about household, coal industry, and petrol price relief. This draft is generally more in line with the role of serving as a starting point for negotiations. "We have to keep reminding ourselves this is a green paper," BP Australasia's Mark Proegler told us. "It's not the final plan." This has left interested parties on all sides assessing where they stand in an ongoing discussion, rather than outright approving or rejecting the CPRS.

¶3. (SBU) The plan was, however, significantly less aggressive than the approach proffered by Australia National University (ANU) Economist Ross Garnaut earlier this month (ref B). The scope of assistance to industry and consumers has been perceived as a clear denunciation, and in fact a clever manipulation, of Garnaut, who has been completely absent from the public debate on the green paper. ANU Professor Warwick McKibbin, a long-time rival of Garnaut's who has been working

on climate change issues since the late 1980s, told us that the Green Paper approach is far more moderate than Garnaut's because it builds in more flexibility in the first few years of implementation. This recognizes that Australia has a particularly carbon intensive economy, according to McKibbin.

¶4. (SBU) Some have gone so far as to argue that there is nothing really new in the plan. Henry Ergas, the very respected head of the Charles River Associates consulting firm (and generally considered close to the opposition Liberal Party) told Econ Counselor July 24 that the CPRS was simply a copy of the Prime Ministerial Task Group on Emissions Trading (TGET) report put to PM Howard in 2007. Ergas argued that while the long-term affects of an emissions QErgas argued that while the long-term affects of an emissions trading system on the Australian economy were "quite alarming," the Rudd government had built enough safety mechanisms into the plan to make short-term impacts almost nil. "The one thing they could have done to differentiate this from the (TGET) plan, to name a target, and hence a notional carbon price, they haven't been able to do," Ergas complained. He was disappointed in the inability of the government to release detailed modeling on the costs of the CPRS until December, after the public commentary period has closed.

Our Emissions Intensive, Our Trade Exposed

¶5. (SBU) The single greatest lightning rod in the report has been the treatment of Australia's industries that have

relatively high emissions and generate most of their earnings through exports. These companies will not be able to pass through to export customers price increases caused by the CPRS. Australian energy giant Woodside's CEO Don Voelte opened fire on July 17 when he argued in an interview in Darwin that the plan's criteria for determining what constitutes an "Emissions Intensive, Trade Exposed" (EITE) industry would leave Australia's rapidly expanding liquefied natural gas (LNG) sector out in the cold. Voelte's complaint was the first of many concerned voices from the energy and industrial process side about the way the government has structured its plans to account for EITEs. Australia Industry Greenhouse Network CEO Michael Hitchens despaired over a perceived lack of rigor in making those decisions. "They've effectively left EITEs out in the cold,"Hitchens told us, "this plan ticks the same boxes as previous plans (like the TGET report) and the state plans, but doesn't achieve the policy objective. The determination of the amount of free permits, and what determines that level, appears to us to be an arbitrary back-of-the-envelope analysis. We've so far been unable to say what an appropriate level of adjustment assistance is. But if we went back to a very basic, and unsatisfactory, sectoral approach, my back of the envelope math says they would need to compensate industry to the tune of about 220 million tons worth of free permits. Their formula provides about 120 million tons, so they're short 100 million tons, and that's just the starting point."

¶6. (SBU) At the end of the day, Hitchens said, the scheme was going to make doing business in Australia more expensive. "90 percent free permits is still a 10 percent tax," he opined. "60 percent free permits is a 40 percent tax. That's acceptable if all parties have the same costs." But not all those looking to invest in Australia are the same, Hitchens argues. "Chevron has a portfolio of possible projects - Gorgon (a massive LNG project) is just one. The costs, the sovereign risks and all the rest have all been analyzed to death by their business cost people. The only thing that's changed is that Australia is making itself more expensive."

¶7. (SBU) Not all energy players were as openly bombastic as
Voelte and Hitchens. BP's Proegler told us that the company
was taking a more cautious approach. "Frankly, we've
absented ourselves from the (posturing for position on EITE
status). It's too early for that. We are working with the
government, which has invited consultation, and waiting to
see how they develop these ideas." At first blush, Proegler
said, neither BP's refining or LNG operations will meet the
definition of EITE as laid out in the green paper. The
decision to remit on a cent-for-cent basis the energy costs
for motorists and many households has also limited the
scheme's appeal, Proegler said. "The government is trying to
strike a balance, but they've limited the pot of money
available from the outset to deal with these issues by the
political choice to neutralize cost growth in petrol, which
we think is a mistake." Facing competition from larger, more
Qwe think is a mistake." Facing competition from larger, more
efficient refineries in Asia (often owned by the same
international companies) Australian refineries will quickly
feel the squeeze under the CPRS, Proegler said. Even with 60
percent free permits, Australia refineries will likely decide
to close their doors rapidly. Whether government should, or
will, prevent that from happening is still to be worked out.

¶8. (SBU) The most concerning to many of our industry contacts
was the formula set out in the report to determine which
processes would receive designation as EITE's. "Of all the
choices they could have made, they made the worst, using
revenue as a denominator" in that formula, Hitchens said.
With Australia's economic boom driven largely by record high
prices globally for commodities and energy, costs in those
sectors were skyrocketing right behind rising profit margins.
As those costs rapidly catch up to high prices, the boom and
bust cycle will mean that revenues shrink rapidly in the
future. Companies that are over the threshold when the
system goes into effect in 2010 will no longer be taking in
the kind of revenues for which they are being asked to pay.
The government has argued that of three choices - employment,

value added, and revenue - revenue is the most transparent
and easiest to account indicator for emissions intensity
across the industrial landscape. But economists and industry
reps agree that it is a "simpler is not always better"
decision by government that may skew who and what gets
compensated.

¶9. (SBU) Australia Petroleum Producers and Explorers (APPEA)
Damian Dwyer said his group shared the concern over the
apparent lack of rigor in setting up the EITE system and the
use of revenues as an indicator of emissions intensity. The
group has argued for the use of a value-added marker, which
the green paper says will be too variable across activities
and therefore impossible to account accurately and comparably
across industries. Use of revenue as a determinant will
leave many key industries like LNG unprotected, Dwyer said,
and will quickly kill off much of the planned A$56 billion in
planned LNG projects now on the books. APPEA, which supports
other elements of the CPRS, is putting forward a proposal to
have emissions resulting from new investments not be counted
under Australia's emissions limits, at least for a period, so
that companies will still have some incentive to invest in
the abundant resources off Australia's shores. Government
appeared to respond to these concerns on July 25 when PM Rudd
suggested that the LNG sector could be provided with some
form of additional assistance to prevent investments fleeing
Australia.

¶10. (SBU) Electricity generators will already receive
substantial assistance under even the light details in the
plan. Coal fired power producers will qualify for financial
assistance for cleaner technology development and free
transitional permits as "most affected" sectors. That hasn't
stopped them from crying out for more. This week, generators
and their representatives in Canberra brandished modeling
results from Brisbane consultants Acil Tasman that show a 20

percent reduction in emissions will drive up household electricity costs 28 percent. Alarming numbers like this are the result of the high emissions intensity of Australia's coal-fired power sector and by the government's unswerving commitment to bring on a higher percentage of costly renewable energy sources. But they will put further pressure on the government to protect the electricity generating sector before finalizing the plan by the end of the year.

Liberal Party: Chasing its Tail?

¶11. (SBU) The Opposition has done the government a favor over the past week by vacillating on whether they support an emissions trading scheme, when they support it, and how they should fight it. A conservative slice of the Liberal Party sees and opportunity to strike back against a plan they never were fully on board with, and have argued this week behind party room doors that a harder line against the scheme is the right response. A more moderate group, headed by former Environment Minister and now Shadow Treasurer Malcolm Turnbull and Shadow Environment Minister Greg Hunt, argue that the Coalition backed emissions trading while in power and can't back away from that given the strong public support Qand can't back away from that given the strong public support for action. They do, however, argue against implementation in 2010, seeing the government's "ambition" to kick off the scheme as a political vulnerability. By delaying implementation until after 2011, which they argue is based on sound economic advice from government under their watch (including Martin Parkinson, who now heads up the Department of Climate Change under Minster Penny Wong), they apparently see an opportunity to deny Rudd a key element of his campaign plank before the next election in 2010.

¶12. (SBU) Opposition Leader Brendan Nelson, having publicly come back to the fold last week and endorsed the concept of emissions trading with a delayed start, is reportedly leaning towards opposing implementation of the scheme. He may be swayed by rumors that former Treasurer Peter Costello is returning to political discourse and floating the idea of a very loose system, where almost all permits are free until China and India take on a binding commitment to reduce their own emissions. Media statements by Nelson and others on the

right of the Party over the week continued to leave room to oppose implementation. Turnbull's econ adviser, Paul Lindwall, told econoff on July 23 that the moderate faction was doubtful that China or India would ever take on a binding commitment, making Costello's supposed idea an empty promise. That could be overcome, Lindwall said, if the Liberals instead tied such a promise not to China or India, but to U.S. adoption of a reduction target.

¶13. (SBU) According to Lindwall, the July 29 Shadow Cabinet and July 30 party room meetings will be dominated by debate on this issue, and he was "very certain" that the Liberal party would coalesce around a strong campaign against implementation in 2010, but not against the overall concept. This would force Labor to either accept their views, or try and turn to the Green Party, who would be unlikely to negotiate away their demands for action that would increase pain on consumers beyond what Labor can bear. This would logically dovetail with industry views. Hitchens told us his members would be far more comfortable with a CPRS backed by the Liberal party instead of one "put together by the Greens and Nick Xenophon (an independent in the Senate)."

Petrol and Lack of International Focus Cause NGOs to Shrug
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¶14. (SBU) The leading NGO voice on climate in Australia called the release of the green paper "a good day, not a great day," for the fight to reduce greenhouse gas emissions in Australia. Climate Institute CEO John Connor agreed with

the chorus of those seeing this as just the beginning of a complicated negotiation. "This is all at play now," Connor said. The Climate Institute expressed dismay that the plan gave away a huge chunk of raised revenue back to motorists as excise relief, but said that it was now almost impossible to claw that back. They were also disappointed that the plan did not include any hint that some of the revenue raised would go to international efforts, like REDD and other global facilities to fight deforestation, as proposed in the Warner-Lieberman bill in the U.S. and under consideration elsewhere. "We need targets and financing to get the developed world to the table," Connor said. The green paper delivers neither.

¶15. (SBU) Comment: The CPRS is an opening bid by government, with enough flexibility to provide relief to most of those who will face higher costs, at least initially, under an emissions trading scheme. It is the beginning of a dialog, and we expect that many more special considerations will be tacked on to the plan before it becomes law. The comprehensive effort to lay a solid foundation has drawn grudging praise even from those contacts with a lot to lose. The biggest loser so far is the Opposition, which is in the position of opposing emissions trading, even after committing while in Government to a similar plan to take effect in f 2012, or simply offering a tepid opposition to the timing, not the substance, of the plan. The government appears confident that it has successfully split the opposition, and the absence of major industry players Qopposition, and the absence of major industry players fighting against any form of emissions trading means that they can carve out enough acceptable protections to put the system in place. End Comment.